By CHARLES A. WAITE and JOSEPH C. WAKEFIELD

Federal Programs for Fiscal 1972

The adoption of a budget balanced at full employment and revenue sharing are the major features of the fiscal 1972 budget. The recent declines in defense spending are reversed.

A BUDGET balanced at full employment, revenue sharing, and a turnabout in defense spending highlight the 1972 Federal budget submitted to Congress late last month.

In presenting the new budget, the administration formally adopted for the first time the principle that the ceiling on Federal spending should be the revenues that would be generated under conditions of full employment. In fiscal 1972, the unified budget shows a $0.1 billion surplus at full employment and an actual deficit of $11.6 billion. (For a further discussion of the "full-employment budget" concept see box on page 14.)

Revenue sharing, the major new spending initiative in the budget, would provide a significant amount of new money for State and local governments in fiscal 1972, and remove restrictions from certain existing grant programs. Obligational authority totaling over $16 billion (on a first full year basis) would be devoted to the new revenue sharing program.

The projected increase in defense spending in the unified budget reverses the trend of the last 2 years. The Department of Defense (DoD) estimates that in terms of 1972 budget prices, DoD and military assistance expenditures in fiscal 1972 will be down nearly $24 billion from fiscal 1968—or roughly the amount some analysts have estimated as the added cost of the Vietnam war. Although the 1972 increase is entirely attributable to higher rates of pay, Defense Department officials have indicated that the sharp cutback in other defense spending has about run its course and that future budgets will emphasize the development and purchase of new weapons and equipment.

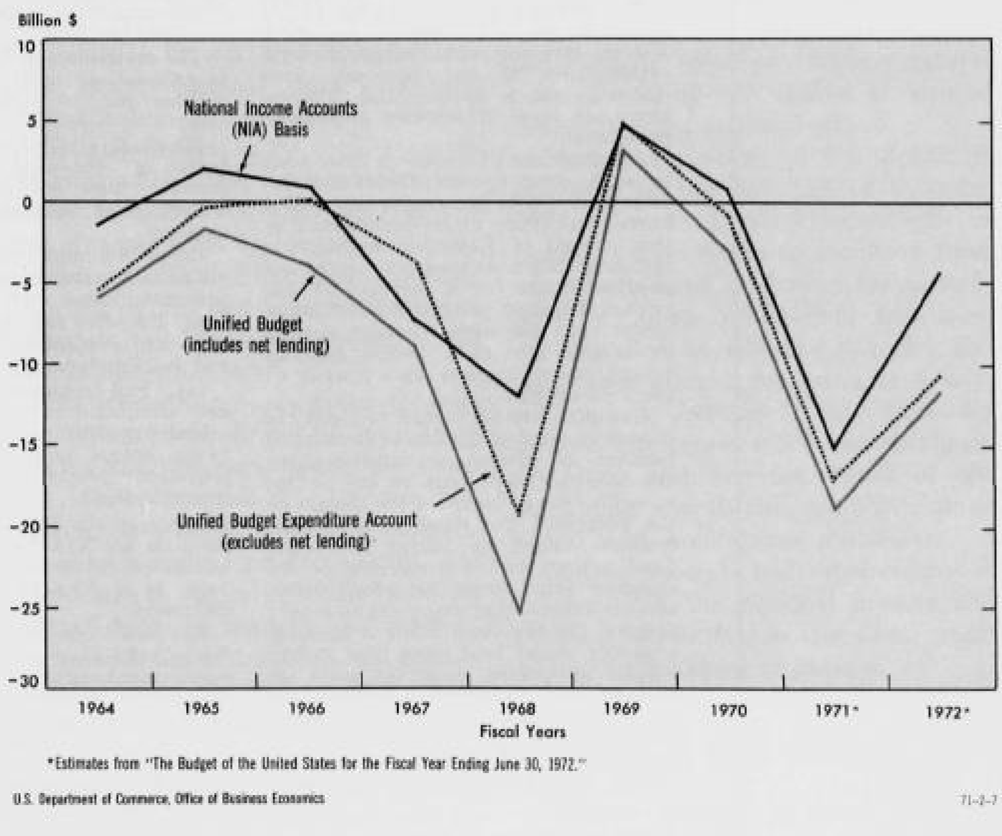
Large gains in outlays and receipts

The budget projects a fiscal 1972 increase in outlays of $16.5 billion, or about the same as the rise in the current year. Civilian programs account for $15.4 billion of the 1972 advance and national defense for the remaining $1.1 billion. Outlays for income security programs (mainly for OASDHI benefits and public assistance) are to rise more than $5 billion, revenue sharing adds $4 billion, and pay increases, including allowances for the proposed all-volunteer force, add more than $3 billion. Other functional areas showing significant gains include natural resources (up $1½ billion) and health ($1 billion).

Receipts are estimated to rise $23.4 billion in 1972, reflecting the rapid growth of the economy assumed in the budget projections. Receipts under existing legislation are estimated to increase by $23.8 billion, while proposed legislation, mainly to increase the social

CHART 7

Federal Fiscal Position
Deficits estimated for FY 1971 and 1972



*Estimates from "The Budget of the United States for the Fiscal Year Ending June 30, 1972."

U.S. Department of Commerce, Office of Business Economics

71-2-7

Table 1.—Federal Government Receipts and Expenditures, Fiscal Years, 1970–72

[Billions of dollars]

	1970 actual	1971 estimate	1972 estimate
Unified budget			
Receipts	193.7	194.2	217.6
Outlays	196.6	212.8	229.2
Expenditure account	194.5	211.1	228.3
Loan account	2.1	1.6	.9
Surplus or deficit (−)	−2.8	−18.6	−11.6
Full-employment surplus	2.6	1.4	.1
National income accounts:			
Receipts	198.7	201.0	225.9
Expenditures	197.9	216.0	230.1
Surplus or deficit (−)	+.8	−15.0	−4.2

Sources: U.S. Office of Management and Budget and U.S. Department of Commerce, Office of Business Economics.

security tax base, would add another $2.8 billion. However, other tax changes—such as liberalized depreciation and a speedup this year in the deposits of certain taxes—would lower receipts by $3.2 billion from fiscal 1971 to fiscal 1972.

The deficit in the unified budget moves from $2.8 billion in 1970 to $18.6 billion in 1971 and $11.6 billion in 1972 (table 1). Under the concepts used in the Federal sector of the national income accounts (NIA), the budget shifts from a surplus of $0.8 billion in fiscal 1970 to deficits of $15 billion in 1971 and $4.2 billion in 1972.

The shrinkage of the deficit in 1972 is more pronounced on the NIA basis than in the unified budget largely because of differences in the timing of receipts. The NIA Federal sector records many receipts on an accrual basis while the budget is on a cash collection basis. Accruals are expected to exceed collections by $1½ billion in fiscal 1971 but by $4½ billion in 1972. This widening of the gap results principally from the rapid growth projected for profits and personal income in fiscal 1972—conditions in which NIA receipts can be expected to grow faster than cash collections. Also contributing to the widening of the gap in 1972 is the fact that changed requirements for the deposit of certain taxes will boost collections in 1971 by over $1 billion but have no effect on NIA accruals.

Table 2.—Council of Economic Advisers' Projection of 1971 GNP

[Billions of dollars]

	Calendar year	
	1970 actual	1971 CEA est.
Total GNP	$976.5	$1,065
Personal consumption expenditures	616.7	675
Gross private domestic investment	135.7	145
Nonresidential fixed investment	102.0	106
Residential structures	29.7	41
Change in business inventories	3.6	3
Net exports	3.0	4
Government purchases	220.5	233
Federal	99.7	98
State and local	120.9	135

NOTE.—Detail may not add to totals due to rounding.

The budget projections are based on an assumed increase in GNP from $977 billion in calendar 1970 to $1,065 billion in 1971 (table 2), a rise of 9 percent compared to last year's advance of 5 percent. Personal income is projected at $868 billion, up $67 billion. Corporate profits before taxes are estimated to increase $16 billion to $98 billion, before adjustment for proposed

The Full-Employment Surplus

The full-employment surplus (FES) is an estimate of the amount by which Federal revenues would exceed Federal expenditures if the economy were operating at a hypothetical full-employment level of activity at current price levels.

Although the FES concept dates back to work done by the Committee for Economic Development in the 1940's, it was first given major prominence by the Council of Economic Advisers in the early 1960's. At that time a practical need was felt for a measure of the impact of budget policy on the economy better than the actual budget surplus or deficit. The 1972 budget recently submitted to Congress relies heavily on the FES concept.

Use of the actual budget to judge the impact of fiscal policy can be misleading because its surplus or deficit reflects the economy's influence on the budget as well as the influence of the budget on the economy. For example, the Government might be taking restrictive fiscal actions but a weakening of the economy could cause the actual deficit to rise, falsely suggesting expansionary policies. On the other hand, a booming economy could lead to a rise in the surplus at a time when tax rates are reduced and expenditure policies become more expansionary. It is in order to abstract from the effect that changing levels of economic activity have on the budget that a single level, that of a "fully-employed" economy, is used to calculate the FES.

The methodology generally employed in calculations of the full-employment surplus can be summarized in four steps:

(1) Real GNP is estimated on the basis of potential full-employment growth, and converted to current dollars using the actual rate of price change.

(2) Full-employment income is divided into various tax bases, such as personal income and corporate profits.

(3) Effective tax rates under present laws are computed for each tax base, and full-employment revenues derived.

(4) Full-employment expenditures are calculated by subtracting from actual expenditures the difference between actual and estimated full-employment levels of unemployment compensation.

Although the FES is generally calculated on an NIA basis, it can also be calculated in terms of unified budget data, as is done in the 1972 Budget document.

As noted in the 1971 *Economic Report*, the absolute level of the full-employment surplus is of limited significance for indicating the extent of fiscal restraint or stimulus. Changes in the FES from period to period are generally considered to be the more significant indicators.

new depreciation rules that give companies greater flexibility in writing off equipment for tax purposes. Allowing for the added depreciation, calendar 1971 profits are estimated at $93.4 billion.

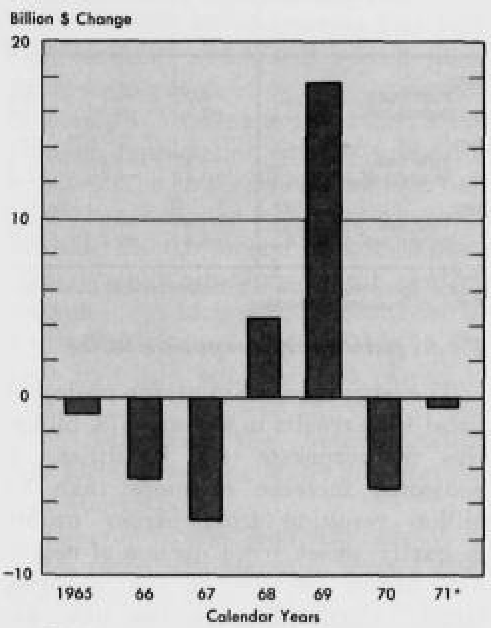
Fiscal policy in calendar 1971

According to the Council of Economic Advisers, the actual NIA deficit in calendar 1971 will be about the same as the $11 billion 1970 deficit. Both expenditures and receipts are projected to rise about $17 billion. Since the net effect of tax changes will lower calendar 1971 receipts by $1¾ billion, the actual gross revenue growth is proiected at about $18¾ billion.

When the NIA data are calculated on the assumption of full employment in calendar 1971, the full-employment surplus is little changed from the 1970 figure (chart 8). This is in contrast to last year, when a shift toward a more expansionary fiscal policy resulted in a $5 billion decline in the surplus. Thus, it appears that the new budget will sustain, but not accelerate, the moderate expansionary course established last year.

CHART 8

Changes in Full Employment Surplus, National Income Accounts Basis



*Estimate

Data: Council of Economic Advisers; 1971 estimated by OBE

U.S. Department of Commerce, Office of Business Economics 71-2-8

Table 3.—Federal Receipts and Expenditures, NIA Basis

[Billions of dollars]

	Fiscal years			Quarterly, seasonally adjusted at annual rates: Calendar 1970			
	1970 actual	1971 estimate	1972 estimate	I	II	III	IV
Federal Government receipts	**198.7**	**200.0**	**225.9**	**195.9**	**196.7**	**194.9**	....
Personal tax and nontax payments	93.7	90.6	99.0	93.4	93.5	89.4	90.3
Corporate profits tax accruals	36.8	35.8	43.5	34.8	34.9	35.7	....
Indirect business tax and nontax accruals	19.4	20.3	21.8	19.3	19.4	20.1	19.5
Contributions for social insurance	48.9	53.2	61.6	48.4	48.9	49.7	49.9
Federal Government expenditures	**197.9**	**215.0**	**230.1**	**197.7**	**210.9**	**206.7**	**209.9**
Purchases of goods and services	100.8	97.9	102.2	102.3	99.7	98.6	98.2
National defense	78.7	74.1	74.0	79.3	76.8	75.8	74.6
Other	22.1	23.8	28.2	23.0	22.9	22.9	23.5
Transfer payments	56.5	69.2	75.0	55.3	64.4	62.9	65.4
To persons	54.5	67.0	72.5	53.4	62.4	61.0	63.4
To foreigners (net)	2.0	2.2	2.5	1.9	2.0	1.9	2.0
Grants-in-aid to State and local governments	22.1	27.0	34.4	23.0	25.1	24.4	25.6
Net interest paid	14.0	14.6	14.3	14.3	14.3	14.8	14.7
Subsidies less current surplus of government enterprises	4.6	6.2	4.2	5.3	5.3	5.6	6.0
Less: Wage accruals less disbursements	.1	−.1	....	2.5	−2.1	−.4	....
Surplus or deficit (−), national income and product accounts	**.8**	**−15.0**	**−4.2**	**−1.7**	**−14.2**	**−11.8**	....

Sources: "The Budget of the United States Government, 1972" and U.S. Department of Commerce, Office of Business Economics.

Projected budget path

If budget projections are realized, the actual NIA deficit will decline from about $13½ billion (annual rate) in the second half of calendar 1970 to about $3 billion in the first half of calendar 1972.

Large increases in both receipts and expenditures are expected in the first half of 1971. The $12½ billion receipts gain largely results from assumed strengthening of economic activity. Although increases in the social security tax rate and base will raise contributions nearly $6 billion (annual rate) in the first quarter, this is largely offset by lower income tax withholdings resulting from tax reform and from reductions in corporate tax liabilities because of the new depreciation rules.

NIA expenditures are estimated to rise $13 billion in the first half. A military and civilian pay raise boosts purchases $2¼ billion (annual rate) in the first quarter. A 6 percent increase in social security benefits, paid in April but retroactive to January, adds $4½ billion (annual rate) to transfer payments in the second. Other transfers and grants-in-aid are also expected to show strong advances. The effect in the second quarter of the postal rate increase scheduled for mid-May is approximately offset by an April pay raise for postal workers.

A strong uptrend in economic activity and rapid growth of receipts are expected to continue in the second half. Expenditures will rise only $5 billion, resulting in a substantial decline in the deficit. Transfers, interest, and subsidies will show a net decline, but the drop in defense spending will halt and nondefense purchases will rise strongly. Grants-in-aid will jump noticeably in the fourth quarter when general revenue-sharing—$5 billion at annual rates—is scheduled to begin.

Further shrinkage of the deficit is projected in the first half of calendar 1972. Despite further reductions in income tax withholding resulting from tax reform, total NIA receipts, particularly corporate profits tax liabilities, are expected to advance sharply. Expenditures should rise more modestly, although a January 1 pay raise for Federal employees will boost purchases of goods and services. Most of the remaining growth will come in grants-in-aid and nondefense purchases.

Federal receipts and expenditures as measured in the national income and product accounts for the fiscal years 1970–72 are shown in table 3.

Fiscal 1972 Receipts

Federal receipts in fiscal 1972 are projected to total nearly $226 billion on the NIA basis, an advance of about $26 billion over the current estimate for fiscal 1971. In fiscal years 1970 and 1971, tax reductions and the sluggishness of the economy limited the growth of receipts to $7½ billion and $1½ billion, respectively.

The projected 1972 increase would rank second only to the record $31 billion advanced in fiscal 1969. That was the first year of the income tax surcharge, and nearly half of the 1969 revenue gain was attributable to tax increases. The projected 1972 increase, by contrast, rests almost entirely on the rapid acceleration of economic activity assumed in the budget. Higher incomes account for $24¾ billion of the 1972 increase, while the net effect of tax changes is to add only $1¼ billion (table 4). For fiscal 1971, a $9 billion increase in receipts resulting from higher incomes is expected to be largely offset by a $7¾ billion decline due to tax changes, mainly the expiration of the surcharge.

The 1972 increase in receipts attributable to tax changes is the net result of many factors, but occurs principally because of revenue increases resulting from: (1) an increase in social security tax rates effective January 1, 1971; (2) a proposed increase in the social security earnings base; and (3) the recently enacted speedup in estate and gift tax payments. These increases more than offset reductions in personal and corporate income taxes resulting from provisions of the Tax Reform Act of 1969 and the recent liberalization of depreciation rules.

CHART 9

Changes in Federal Government Receipts (NIA Basis)

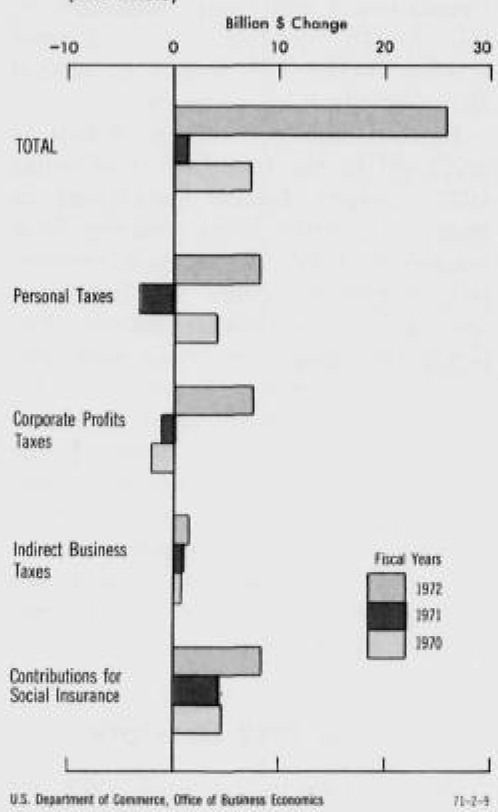


Table 4.—Breakdown of Changes in Federal Receipts, NIA Basis

[Billions of dollars]

	Change from previous fiscal year		
	1970	1971	1972
Total receipts, NIA basis	7.4	1.3	25.9
Amount due to higher incomes	7.9	9.3	24.7
Amount due to tax changes	-.5	-8.0	1.2
Personal tax and nontax payments	4.2	-3.1	8.4
Amount due to higher incomes	6.2	6.5	10.3
Amount due to tax changes	-2.1	-9.6	-1.9
Corporate profits tax accruals	-2.1	-1.0	7.7
Amount due to higher incomes	-1.9	.5	9.1
Amount due to tax changes	-.2	-1.5	-1.4
Indirect business tax and nontax accruals	.8	.9	1.5
Amount due to higher incomes	.8	.6	1.4
Amount due to tax changes	------	.3	.1
Contributions for social insurance	4.7	4.3	8.4
Amount due to higher incomes	2.8	1.6	3.8
Amount due to tax changes	1.8	2.8	4.6

Source: Estimates by the U.S. Department of Commerce, Office of Business Economics.

Tax relief cuts rise in personal taxes

Personal tax and nontax payments are projected to reach $99 billion in fiscal 1972, an increase of $8½ billion. A gain of about $10½ billion attributable to higher incomes will be partly offset by a net loss of nearly $2 billion because of tax changes.

Tax relief measures adopted in the Tax Reform Act of 1969 will cut receipts about $2½ billion between 1971 and 1972, and another $¾ billion will be lost because of the proposed change in depreciation rules (affecting taxes on unincorporated business). These reductions are partly offset by a $1½ billion nonrecurring increase in estate and gift taxes; under recently enacted legislation, the estate tax must be paid 9 months after death instead of 15 months as previously, and gift taxes must be paid quarterly rather than annually. The major impact of this speedup will be felt in the fourth quarter of 1971 and the first quarter of 1972.

Disposable income has already been significantly affected by the tax relief aid reform measures enacted in 1969, principally those raising the personal exemption and the standard deduction and eliminating the phaseout of the low income allowance. Withholding rates were lowered in January and July 1970 and January 1971 to reflect some of the new measures, and will be reduced again in January 1972. However, nonwithheld payments, mainly for final settlements, are expected to increase, largely because some of the reform measures increase taxes on incomes not generally subject to withholding. The new depreciation rules, however, should reduce nonwithheld payments in 1972.

Table 5 shows the estimated net impact on personal tax payments of the various tax reform and relief measures, repeal of the investment credit, and the new depreciation rules. The estimates, which rest on the economic assumptions used in the budget, run from calendar 1970 through calendar 1972, by half year periods, at seasonally adjusted annual rates.

Table 5.—Impact of Tax Reform, Relief, etc. on Personal Tax Payments (NIA Basis)

[Billions of dollars, seasonally adjusted at annual rates]

	Total	Withheld	Other
1970:			
First half	-0.3	-0.7	0.4
Second half	-2.1	-2.5	.4
1971:			
First half	-4.8	-5.6	.8
Second half	-5.2	-6.0	.8
1972:			
First half	-7.8	-8.6	.8
Second half	-8.4	-9.2	.8

Source: Estimates by the U.S. Department of Commerce, Office of Business Economics.

Profit gain spurs corporate levies

The large increase in profits projected fiscal 1972 results in a sharp $7¾ billion rise in corporate tax liabilities. A projected increase of more than $9 billion resulting from higher profits is partly offset by a decline of nearly $1½ billion because of tax changes, largely attributable to the new depreciation rules.

The projected 1972 increase in profits

tax liabilities rests on an assumption that pretax profits, excluding the effect of the new depreciation rules, will rise nearly $22 billion from fiscal 1971 to fiscal 1972. The new depreciation rules, which become effective in calendar 1971, are expected to reduce corporate tax liabilities by $1 billion in fiscal 1971 and $2¼ billion in fiscal 1972. Other tax changes, resulting from already approved tax reform measures and repeal of the investment credit, or from a new proposal to defer tax liabilities on certain foreign trade operations, have little net impact on the 1972 change in liabilities.

New depreciation rules

The liberalized depreciation rules were announced by the President in January. Although the changes will not go into effect until public hearings have been held it is expected that the new regulations will be formally adopted by late spring retroactive to January 1. Briefly summarized, these changes, which do not require new legislation, will:

(1) Authorize the Internal Revenue Service to accept depreciation based on an optional "asset depreciation range" (ADR) under which each business can choose to take its depreciation deductions over a period up to 20 percent shorter (or longer) than present standard "guideline" lives fixed in July 1962.

(2) Provide an alternative first year "convention" which will permit more depreciation soon after new equipment is installed. Under the new rules, a full year of depreciation can be taken for assets placed in service in the first half of a year, and one half year for those installed in the second half of a year. This is an alternative to the present convention, which permits deduction of half of the annual depreciation in the year in which equipment is placed in service.

(3) Terminate the "reserve ratio" test for determining limits on depreciation allowances.

The new rules generally apply to assets physically placed in service after December 31, 1970, but do not apply to buildings and real estate improvements. Pending further study the ADR will not be applicable to electric, telephone, gas, or water utilities.

In the national income accounts, the impact of the new depreciation rules will show up in higher capital consumption allowances, lower corporate profits before tax and, consequently, lower corporate tax liabilities. The effective tax rate for corporations (corporate tax liabilities divided by corporate profits) will be essentially unchanged by the new rules. Corporate cash flow will, of course, be increased. For calendar 1971, the Treasury estimates that corporate capital consumption allowances will be higher, and pretax profits lower, by about $4.6 billion; corporate tax liabilities will be reduced, after tax profits and cash flow increased, by about $2.1 billion. (Noncorporate capital consumption allowances will be $1.2 billion higher.)

Other receipts

Indirect business tax and nontax accruals are projected to increase $1½ billion in fiscal 1972, with the advance spread over a wide range of excise taxes and customs duties. Tax changes are a negligible factor; a small levy on air travelers to finance aircraft security measures is the only change. Under recently passed legislation, current excise tax rates on automobiles and telephone service—now 7 percent and 10 percent, respectively—will be retained through calendar 1973.

Contributions for social insurance, the second largest category of NIA receipts, are expected to increase a record $8½ billion in fiscal 1972, to $61½ billion. The projected increase is nearly twice the 1971 advance and the largest percentage gain since fiscal 1967.

About $4 billion of the expected 1972 increase results from a large anticipated rise in the dollar volume of payrolls covered by the social security and other retirement and social insurance programs. The remainder, about $4½ billion, is attributable to tax changes. Over $1½ billion represents the first full-year effect of the January 1, 1971, increase in the combined employer-employee payroll tax from 9.6 percent to 10.4 percent. Another $2½ billion represents the effect of the proposed increase in the earnings subject to the social security tax from $7,800 to $9,000. Both the House and the Senate approved the increase last year, but final approval of a single bill by both Houses was not achieved before adjournment.

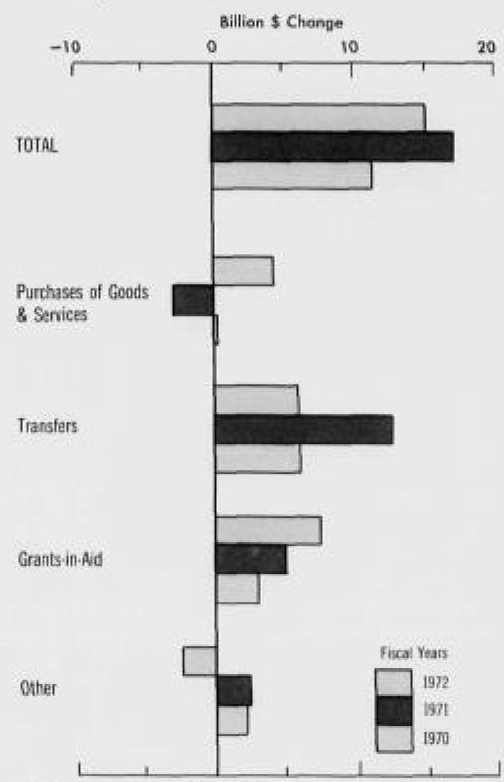
The increase in the tax base, which is proposed to be effective January 1, 1971, would have its most marked effect on actual revenue in the second half of calendar 1971, as persons would reach the maximum later in the year than under the lower base. However, on a seasonally adjusted basis in the national income accounts, the effect will be to increase contributions approximately $2½ billion (annual rate) in the first quarter of calendar 1971.

Fiscal 1972 Expenditures

Federal expenditures on the NIA basis are projected to increase about $15 billion in fiscal 1972, compared with a $17 billion advance forecast for the current fiscal year. Defense purchases are to be basically unchanged in 1972. Major increases are projected for nondefense purchases, grants, and transfer payments, while other expenditures—for subsidies and interest—are to decline.

CHART 10

Changes in Federal Government Expenditures (NIA Basis)



U.S. Department of Commerce, Office of Business Economics 71-2-10

Decline in defense purchases halted

National defense purchases are estimated to remain essentially unchanged at $74 billion in 1972 following an expected $4½ billion decline in the current fiscal year, and increase in the preceding 5 years.

As noted earlier, defense spending in the unified budget is projected to increase in 1972. Table 6 shows functional detail of unified budget defense outlays, and a reconciliation of those outlays to defense purchases on the NIA basis.

Across-the-board pay raises for military and civilian personnel were effective in January 1970 and January 1971 and another is budgeted in January 1972. In addition, higher pay for recruits and lower-grade enlistees is proposed in fiscal 1972 as part of the transition to an all-volunteer force. Pay raises added about $1 billion to defense purchases in fiscal 1970, and are expected to add $2¾ billion in 1971 and $5½ billion in 1972; excluding these amounts, defense purchases decline about $6½ billion in 1971 and $2¾ billion in 1972.

Table 6.—Relationship of National Defense Outlays in the Unified Budget to National Defense Purchases on the NIA Basis 1970–72

[Billions of dollars]

	1970 actual	1971 estimate	1972 estimate
Department of Defense military	77.2	73.4	75.0
Military personnel	23.0	21.7	20.1
Retired military personnel	2.8	3.4	3.7
Operation and maintenance	21.6	20.4	20.2
Procurement	21.6	18.4	17.9
Aircraft	7.9	6.6	6.2
Missiles	2.9	3.0	3.3
Ships	2.1	2.0	2.3
Vehicles and ordnance	5.6	4.1	3.6
Electronics and communications	1.2	1.0	.9
Other	1.9	1.6	1.6
Research, development, test, and evaluation	7.2	7.3	7.5
Other	.9	1.2	1.8
Civilian and military pay increases		.9	2.4
All-volunteer force (proposed legislation)			1.2
Military assistance	.7	1.1	1.0
Atomic energy and other defense-related activities	2.4	1.9	1.5
Total unified budget expenditures for national defense	80.3	76.4	77.5
Less: Transfers, grants, interest	3.1	3.6	4.0
Timing differences and other adjustments	−1.5	−1.3	−.5
Equals: National defense purchases, NIA	78.7	74.1	74.0

Source: "The Budget of the United States Government, 1972", U.S. Department of Defense, and the Department of Commerce, Office of Business Economics.

Excluding the pay raises, military personnel costs are expected to decline substantially in 1972 as the result of a further reduction—nearly 200,000—in the size of the Armed Forces. It is estimated that by June 30, 1972, the level of military personnel will be 2.5 million, a force nearly 200,000 below pre-Vietnam levels.

Operation and maintenance outlays will also be lower in fiscal 1972, reflecting lower support requirements for general forces and a modest reduction in DoD civilian personnel. Civilian employment is scheduled to be reduced only 18,000 during the period in contrast to 50,000 in 1971.

Procurement outlays are also expected to drop in 1972, but the $½ billion decline is considerably less than the $3½ billion drop estimated for the current fiscal year. The only procurement increases in 1972 are for missiles and ships, each up about $½ billion. The increase in missiles is for continued conversion of Polaris submarines to fire the improved Poseidon and for the purchase of Minuteman III and short-range attack missiles. The Navy will also spend more money for new high-speed nuclear subs and destroyers.

An important indicator of future DoD spending, total obligational authority (TOA), is expected to increase more than unified budget outlays from fiscal 1971 to 1972—over $4 billion versus about $1½ billion. Over $2¾ billion of TOA is for pay raises and the proposed all-volunteer force, while the other large increase—about $1 billion —is in research and development spending. On balance all other TOA is up $½ billion. Hard good purchases in the NIA data are recorded on a delivery basis and show a modest increase in 1972.

Atomic energy and other defense-related purchases are projected to drop by over $½ billion in fiscal 1972, mainly because of efforts to reduce strategic stockpiles.

The recent reductions in defense spending have had a significant impact on employment. As can be seen in chart 11, the estimated average level of employment attributable to DoD expenditures in fiscal 1971 is about 1¾ million below the peak of over 8 million reached in fiscal 1968. About 1½ million of this reduction was in private employment, 400,000 in military personnel, and 75,000 in DoD civilian personnel. The estimates of the private employment impact were derived through use of the interindustry model approach and include not only directly affected defense employment, but also employment in supporting industries; no attempt was made to measure the additional employment derived from income multiplier or accelerator effects.

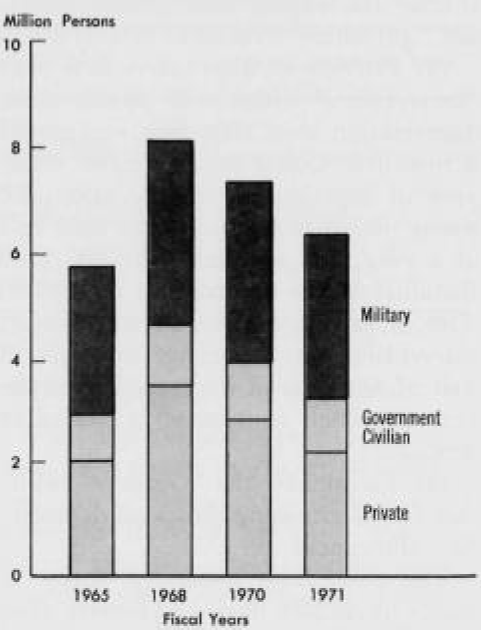
Nondefense purchases up

Nondefense purchases are projected to show a record increase of nearly $4½ billion in fiscal 1972, substantially more than the $1¾ billion advance expected this year. Agriculture will account for over $1½ billion of the 1972 increase, pay increases for about $¾ billion, preparing for welfare reform for $½ billion, with the remaining $2 billion distributed over a wide range of other programs.

The large increase in agriculture expenditures is centered in the Commodity Credit Corporation and is based on the assumption that crops will be larger in 1971 than in 1970—particu-

CHART 11

Defense-Related Employment



Note.– Figures are annual averages of the estimated amount of employment generated by Defense Department military expenditures. Government civilian includes small amount of State–local employment. Source: Bureau of Labor Statistics; 1971 estimate as published by Council of Economic Advisers.

U.S. Department of Commerce, Office of Business Economics 71-2-11 larly corn, which was affected by a blight last year, and wheat and cotton. Among the more important increases in other nondefense purchases are boosts in programs dealing with law enforcement and justice, water and air pollution control, medical and health care, and manpower training. Space outlays suffer a further reduction, amounting to $½ billion. NASA purchases are estimated to be somewhat more than $3 billion in 1972, down nearly 50 percent from the peak of $6 billion in fiscal 1966.

Transfers and grants higher

Government expenditures affect aggregate demand not only directly, through purchases of goods and services, but also indirectly through outlays such as transfer payments, grants-in-aid, interest payments, and subsidies. Expenditures other than for purchases of goods and services are projected to increase nearly $11 billion in fiscal 1972, following a record $20 billion increase in 1971, when transfers to persons rose $12½ billion. Transfers, augmented by a boost in social security benefits, will increase $5½ billion in 1972. Grants to State and local governments, including revenue sharing of $4 billion, are to rise nearly $7½ billion. The other spending categories—net interest paid, subsidies (less the current surplus of government enterprises), and foreign transfers—are projected to show a net decline of $2 billion, after increasing $2½ billion in 1971.

The anticipated 1972 increase in transfer payments to persons is the sixth consecutive rise of more than $5 billion, bringing payments from $32 billion in fiscal 1966 to a projected $72½ billion in 1972. (Defense purchases increased somewhat more than $19½ billion over the same period.) The substantial growth in recent years has resulted from the introduction of new programs, such as medicare, as well as higher average benefits and a growing number of beneficiaries in existing programs. In fiscal 1971 and 1972 higher unemployment benefits are also a factor contributing to the rise of transfers.

Social security benefits (excluding Medicare) account for about $3½ billion of the 1972 advance, with nearly $2 billion resulting from proposals to increase benefits by 6 percent for 27 million beneficiaries and make other program modifications, effective early in calendar 1971. Automatic adjustment of benefit levels to keep pace with the cost of living is proposed beginning January 1, 1973. Hospital and medical payments under the medicare program are projected to increase $¾ billion in 1972. That rise would put payments over $8½ billion, or more than 2½ times the level in fiscal 1966, the first year of the program.

Unemployment benefits are projected to decline over $¾ billion in 1972, to about $4½ billion, after rising $2½ billion in the current fiscal year. The budget assumes that the unemployment rate will average 4.8 percent in fiscal 1972 as compared with 5.5 percent in fiscal 1971. The Council of Economic Advisers states that the unemployment rate can be projected to drop to about 4½ percent by mid-1972, well below the January 1971 level of 6 percent.

Other transfer payments are expected to rise $2½ billion, with the largest increases occurring in military and civilian pensions ($1 billion), food stamps ($½ billion), and veterans readjustment programs ($½ billion). The large rise in pensions results from an increase in the number of retirees and cost-of-living increases in benefits required by law. Extension of the food stamp program has increased its cost from about $½ billion in fiscal 1968 to almost $2 billion in 1972.

The 1972 budget makes no provision for transfer payment increases as a result of welfare reform (the family assistance program), but it does include funds for planning costs. Under proposed legislation, payments to individuals would begin in fiscal 1973. The first full-year cost of the program is estimated at about $4 billion, of which $2½ billion would be transfer payments and $1½ billion grants-in-aid.

Revenue sharing boosts grants

Grants-in-aid to State and local governments are projected to total $34½ billion in 1972, up nearly $7½ billion from the current year. The proposed revenue sharing program is estimated to add $4 billion of new funds to grants in 1972. The program would provide for two forms of sharing: (1) general revenue sharing, which would share a portion of Federal revenues without program or project restrictions; and (2) special revenue sharing, consisting of certain existing grants but without the requirement of matching funds.

General revenue sharing would start in the fourth quarter of calendar 1971. It would be paid each year in equal quarterly installments. The funds would be allocated primarily on the basis of State population, with the local governments sharing in the payments. The amount of general revenue sharing would grow with the growth of the Federal personal income tax base. Special revenue sharing, to go into effect by January 1, 1972, would be funded by general revenues and distributed in various ways, depending upon the program involved. The budget allocations for general and special revenue sharing in fiscal 1972 are shown in table 7.

Expenditures for the largest grant program, public assistance, are expected to increase about $1½ billion in 1972 to nearly $11 billion, following a rise of almost $2½ billion in fiscal 1971. The smaller increase reflects a projected slowdown in the growth of the number of families with dependent children receiving aid.

Table 7.—Revenue Sharing in Fiscal 1972

[Billions of dollars]

	Total	New funds	Converted grants
Total	$13.6	$4.0	$9.6
General	3.7	3.7	
Special	9.9	.3	9.6
Urban community development	2.1		2.1
Rural community development	1.0		1.0
Elementary and secondary education	2.9	.1	2.8
Manpower training	1.6	.2	1.4
Law enforcement	.4		.4
Transportation	1.9		1.9

Education grants, another large category, are projected to rise $½ billion in 1972 to $3½ billion. Most of the advance is in emergency school assistance, which aids State and local governments in meeting the problems of desegregation and "racially impacted" school districts.

Grants for higher education are projected to decline in 1972, although transfers and loans in this area would increase. Proposed new legislation would drastically alter the scope and nature of Federal aid to higher education. It would aim to insure that no qualified student would be barred from college by lack of funds. A single aid package—consisting of grants, work-study payments, and subsidized loans—would be provided to lower income students. A National Student Loan Association (NSLA) would provide funds to banks and colleges for loans to students at all income levels. These loans would be either subsidized or guaranteed by the government. In addition, authority will be requested to provide students with up to $1,500 in extra loans based on the cost of the institutions they attend.

The remaining increase in grants, about $1¾ billion, is spread among a wide variety of programs, principally those for law enforcement assistance, manpower development and training, community development, and environmental protection. The latter program calls for substantial increases—$200 million in 1971 and over $½ billion in 1972—to construct municipal waste treatment facilities. Highway grants are expected to advance only slightly in 1972.

Interest payments decline

Net interest paid is projected to decline about $½ billion in 1972. This reduction would be the first since fiscal 1961 and would follow average increases of more than $1 billion since fiscal 1966. The decline is based on an assumption of slightly lower interest rates on new borrowing and a slowdown in the growth of publicly-held debt.

Subsidies (less the current surplus of government enterprises) are projected to drop $2 billion in 1972, largely because increased postal rates are to reduce the postal deficit. The budget estimates assume that a rate increase, including a 2-cent rise on first class mail, will become effective by May 15, 1971, providing additional revenues of $156 million in 1971 and over $1½ billion in 1972. The rate increases more than offset a postal pay raise assumed for April 1, 1971, which adds $150 million to expenditures in fiscal 1971 and slightly more than $½ billion in 1972.

Agriculture subsidies are expected to decline $¾ billion in 1972. The reduction is centered in direct payments to wheat, feed-grain, and cotton producers, and results from the annual ceiling of $55,000 per crop established by the Agricultural Act of 1970. However, Department of Agriculture officials cautioned that these estimates are tentative because of uncertainty over program participation.

Other types of subsidies on balance are up slightly from 1970 levels, with significant increases projected for rent supplements and rental housing assistance.

Budget-NIA Reconciliation

The differences between the two budget concepts can be summarized in the following major categories: (1) procedures for netting; (2) timing of expenditures; (3) definition of loans; and (4) all other. Table 8 shows a summary reconciliation of the Federal deficit or surplus as recorded in the unified budget and in the national income accounts.

By focusing on the surplus, it is possible to disregard the difference in the treatment of netting. While this difference is substantial, it affects only the levels of receipts and expenditures and not the size of the surplus or deficit as measured by the two budget concepts.

The unified budget records receipts on a cash collections basis while NIA receipts are on an accrual basis, except for personal income taxes which are recorded on a payments basis. In fiscal 1972, cash collections are estimated to exceed NIA receipts by $4½ billion.

The two budget measures also differ in the timing of expenditures except interest, which is recorded on an accrual basis in both budgets. The unified budget records expenditures other than interest on a checks-issued basis. The NIA records most purchases of goods and services on a delivery basis (in line with the general practice throughout the national accounts), and most other expenditures on a checks issued basis. Deliveries are expected to exceed payments by $½ billion in 1972.

Lending is excluded from the expenditure account of the unified budget and from the Federal sector, but the two measures differ in the definition of loans. The unified budget treats most foreign loans, and those domestic loans whose repayment is contingent rather than mandatory, as expenditures and includes them in the expenditure account. The NIA excludes all loans except CCC price-support loans, which are recorded as Federal purchases and as a part of farm income. Loan transactions excluded from the NIA but included in the unified budget's expenditure account are estimated to exceed $2 billion in 1972.

A number of other differences remaining are combined under "all other" in table 8. These include foreign currency transactions, purchases and sales of land, geographical differences, and several other items of lesser importance. Altogether, they amount to less than $½ billion in 1972.

Table 8.—Reconciliation of Unified Budget Surplus or Deficit with Federal Surplus or Deficit, National Income Accounts (NIA) Basis, Fiscal Years 1970–72

[Billions of dollars]

	1970 actual	1971 estimate	1972 estimate
Unified budget surplus or deficit (−)	−2.8	−18.6	−11.6
Plus: Net lending	2.1	1.0	.9
Equals: Expenditure account surplus or deficit (−)	−.7	−17.6	−10.7
Plus: Excess of tax accruals over collections	.0	1.5	4.4
Excess of payments over deliveries	−1.0	−1.6	−.6
Loan transactions excluded from NIA, but included in expenditure account	1.8	2.4	2.2
All other	.3	−.3	.4
Equals: Federal surplus or deficit (−) on NIA basis	.6	−15.9	−4.2

Source: U.S. Department of Commerce, Office of Business Economics.

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